IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. 94

WM. G. LEWIS, Trustee,
Petitioner,
vs.
MANUFACTURERS NATIONAL BANK OF DETROIT,
Respondent

BRIEF FOR RESPONDENT

HENRY I. ARMSTRONG, JR.,
Attorney for Respondent,
1400 Buhl Building,
Detroit 26, Michigan.

BODMAN, LONGLEY, BOGLE, ARMSTRONG
& DAHLING,
RICHARD D. ROHR,
CARSON C. GRUNEWALD,
Detroit, Michigan,
Of Counsel.

Interstate Brief & Record Co., 642 Beaubien St., Detroit 26, Michigan

TABLE OF CONTENTS

INDEX

Cases:

Page

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. 94

WM. G. LEWIS, Trustee,
Petitioner,
vs.
MANUFACTURERS NATIONAL BANK OF DETROIT,
Respondent

BRIEF FOR RESPONDENT

COUNTER-STATEMENT OF QUESTION PRESENTED FOR REVIEW

Respondent rejects Petitioner's statement of the question presented and believes that it may be more precisely stated as follows:

> DOES SECTION 70c OF THE BANKRUPTCY ACT INVEST THE TRUSTEE WITH THE STATUS OF A FICTIONAL CREDITOR EXTENDING CREDIT AT ANY ADVANTAGEOUS TIME DURING AN UNLIMITED PERIOD PRIOR TO DATE OF BANKRUPTCY WITH THE RESULT THAT THE

TRUSTEE CAN AVOID A MICHIGAN CHATTEL MORTGAGE FILED OVER FIVE MONTHS PRIOR TO DATE OF BANKRUPTCY BECAUSE MICHIGAN LAW MADE SUCH MORTGAGE VOID AS AGAINST SIMPLE CONTRACT CREDITOR EXTENDING CREDIT DURING THE PERIOD BETWEEN DATE OF EXECUTION AND DATE OF FILING?

COUNTER-STATEMENT OF THE CASE

There is no factual issue in this case, but Respondent rejects Petitioner's statement as inadequate, and submits the following brief statement:

Respondent, a national banking association with its main office in Detroit, Wayne County, Michigan, is the holder of a note secured by a chattel mortgage properly executed and delivered by the Bankrupt under date of November 4, 1957 covering a 1953 Pontiac automobile. The Bankrupt gave the note and chattel mortgage in exchange for a loan from the Respondent made through its Grand River-Dundee branch office. After making a credit investigation of the Brankrupt, the proceeds of the loan were disbursed on November 5, 1957. On that date, the branch office forwarded the note and chattel mortgage to Respondent's downtown Michigan-Griswold office where on November 6 and 7, 1957 it was reviewed for proper figures, interest rate, and signature, etc., and processed for credit life insurance on the Bankrupt, machine accounting records and filing. The chattel mortgage was then filed with the Wayne County Register of Deeds at 10:21 a.m. on November 8, 1957. Wayne County was the proper county for filing said mortgage.

No evidence was introduced as to the existence of a creditor of the Bankrupt who became such between the

time of the execution and delivery of the chattel mortgage and the time of the filing of the chattel mortgage.

About five months later (April 18, 1958), the Bankrupt filed a voluntary petition in bankruptcy in the District Court upon which an adjudication in Bankruptcy was duly entered.

On June 13, 1958 the referee in bankruptcy held that the mortgage was void as against a trustee in bankruptcy. The District Judge reversed the order of the referee and the Sixth Circuit Court of Appeals affirmed the judgment of the District Court. Trustee applied to this Court for a Writ of Certiorari and Certiorari was granted on June 27, 1960.

SUMMARY OF ARGUMENT

Respondent's argument that the decision of the Court of Appeals for the Sixth Circuit should be sustained may be summarized as follows:

A. Consideration of the Michigan statutory background.

B. The construction of Section 70c reaffirmed by the Court of Appeals is sound and should be sustained because:

1. The history and genesis of present Section 70c clearly support such construction.

2. Express Congressional intent as to the last amendment to Section 70c (in 1952) clearly supports such construction and subsequent action by Congress confirms such intent.

3. The statutory context of Section 70c supports such construction and negates Petitioner's arguments.

4. The plain meaning of present Section 70c compels such construction.

C. Sound authority in other jurisdictions supports the Court of Appeals' construction and the only authority to the contrary (in the Second Circuit) has no valid basis.

D. Strong practical and policy considerations confirm the soundness of the decision by the Court of Appeals.

1. The mischievous effects of *Constance* on Chattel Mortgage financing.

2. The limitations problem.

3. Effect of Constance upon other commercial transactions.

ARGUMENT

PRELIMINARY STATEMENT

Petitioner requests this Court to reverse the decision of the Court of Appeals below which flatly rejected his contention that a trustee in bankruptcy can invalidate a Michigan chattel mortgage filed within four days after execution and over five months before date of bankruptcy by distilling from Section 70c of the Bankruptcy Act (11 U. S. C., Section 110c) a fictional status of interim creditor even though no actual interim creditor is shown to exist at date of bankruptcy or to have existed at any time prior thereto. Petitioner's proposition was similarly rejected by the District Court.

Contrary to Petitioner's suggestion in his brief (at pages 6-9), there is no issue here as to the source of the rights of a trustee in bankruptcy. That source is the Bankruptcy Act and Petitioner's claim depends entirely upon the narrow legal question as to the meaning of Section 70c. Petitioner does not urge or contend that there was an actual interim creditor giving the trustee a position of attack under Section 70e of the Bankruptcy Act (11 U. S. C., Section 110e). Nor is there any claim that Section 60 (11 U. S. C., Section 96), dealing with preferences, or Section 67 (11 U. S. C., Section 107), dealing with judicial liens and fraudulent transfers, are here involved.

While the foregoing states the precise issue before this Court, it should be emphasized that also involved is the broader concept of the true role of the trustee in bankruptcy.

It would seem clear from any basic text on bankruptcy and from the Bankruptcy Act itself that one major aspect of the trustee's role is the fair and equitable accommodation of the interests of secured and unsecured creditors in the bankrupt's estate within the compass of certain guide lines set forth in the statute and amplified by judicial decision.

Inherent in Petitioner's notion as to Section 70c, however, is a rewriting of this role with the trustee cast as an adventurer with letter of marque to voyage an indefinite period prior to date of bankruptcy in search of situations where the interposition of a hypothetical creditor reaps an advantage to the unsecured creditors which no one of them could rightly claim.

Respondent will proceed to demonstrate that Congress did not so intend.

A. THE MICHIGAN CHATTEL MORTGAGE FILING STATUTE.

Although this appeal is not based upon a difference as to the construction of the applicable Michigan chattel mortgage filing statute (Michigan Compiled Laws 1948, Section 566.140; Michigan Statutes Annotated, Section 26.929), a review of this statute and its recent amendments and of the judicial gloss thereon is appropriate here, both to place this case in its proper context and to indicate the extravagant consequences of Petitioner's position.

For many years prior to 1956, the Michigan statute read in pertinent part:

> "Every mortgage or conveyance intended to operate as a mortgage of goods and chattels which shall hereafter be made which shall not be accompanied by an immediate delivery and followed by an actual and continued change of possession of the things mortgaged, shall be absolutely void as against the creditors of the mortgagor, and as against subsequent purchasers or mortgagees in good faith, unless the mortgage or a true copy thereof shall be filed in the office of the register of deeds of the county where the goods or chattels are located, and also where the mortgagor resides, * * *."

Under this language, the chattel mortgage, upon filing, becomes valid against future creditors and against creditors prior to the date of its execution, but remains vulnerable to attack by any interim creditor, that is, a creditor who extended credit during the period between time of execution and time of filing.

In *General Motors Acceptance Corporation v. Coller*, (6th Cir. 1939), 106 F. (2d) 584, cert. den. 309 U. S. 682, 60 S. Ct. 723, the Court ruled that the language quoted rendered void against a trustee claiming *under Section 70e* a chattel mortgage filed six days after execution where

there was an actual creditor who extended credit in the interim between execution and filing. Language in this opinion indicated that there was no basis in the Michigan statute for a reasonable grace period which would protect a mortgagee against an interim creditor.

In a subsequent line of decisions, the most recent and drastic of which is *In re Tobias,* 150 F. Supp. 288 (1957), the Federal District Courts have ruled that a trustee in bankruptcy, under Section 70e, could set aside any Michigan chattel mortgage if there existed an *actual* interim creditor with a provable claim. In *Tobias,* the chattel mortgage had been filed within twenty-four hours of its execution, but, during such period, an ice cream company had sold and delivered certain merchandise on account to the mortgagor, a restaurant owner.

The difficulties and unworkability of this chattel mortgage act had been recognized by the Michigan Legislature prior to the *Tobias* decision, for, effective August 11, 1956, Public Act 153 of 1956 added this proviso:

> "Provided, however, that any such mortgage shall not be void in the case of insolvency proceedings as against the creditors of the mortgagor if filed within 14 days from the date thereof."

The phraseology employed in establishing the fourteen-day grace period raised new questions as to legislative intent and the proper relationship of such proviso to the Federal Bankruptcy Act which were not resolved until the decision in *Hertzberg v. Associates Discount Corporation,* (6th Cir. 1959) 272 F. 2d 6; cert. den. 362 U. S. 950, 80 S. Ct. 861.

By Public Act 233 of 1957, effective September 27, 1957, the legislature replaced the troublesome 1956 proviso with the following language:

> "Provided, however, that no *purchase money mortgage* shall be void as against the creditors of the mortgagor if filed within 14 days from the date of the execution of such mortgage."

Act 233 was in force when the mortgage involved in this case was executed and filed, but such mortgage is not a purchase money mortgage and, accordingly, the fourteen-day grace period was not available to shelter Respondent against a claim by the trustee under Section 70e if an actual interim creditor had been shown to exist.

There being no showing in this case of an actual interim creditor, the trustee based his attack upon his interpretation of Section 70c that such section not only permits him to hypothesize a creditor, but also to hypothesize that such creditor extended credit in the four-day period between execution and filing of this mortgage.

It was evident that the trustee's position in this case had the consequence of calling into question virtually every Michigan chattel mortgage (other than for purchase money), no matter how promptly filed, and to change the Michigan chattel mortgage from a security device to a snare for the unwary.

Accordingly, by Public Act 110 of 1959 the Michigan legislature again dealt with the problems created by the decisions under Section 70e and the challenges made by bankruptcy trustees under Section 70c by providing a ten-day grace period for all chattel mortgages.

Such act, however, would appear to be prospective only, leaving in jeopardy mortgages executed prior to its effective date, March 19, 1960. Further, the precise question involved in this case may arise even under the amendment effected by Public Act 110 where a mortgagee files

his mortgage more than ten days after date of its execution.

The question, moreover, is not limited geographically to Michigan or categorically to the chattel mortgage security device. ~~As will be fully~~ demonstrated in the argument which follows, Petitioner's notion creates problems in other states and in other major areas of the law affecting commerce and finance.

B. THE GENESIS OF SECTION 70c, CONGRESSIONAL INTENT WITH RESPECT TO THE 1952 AMENDMENT THEREOF, CONSIDERATION OF THE STATUTORY CONTEXT AND ANALYSIS OF THE LANGUAGE EXPRESSING SUCH INTENT ALL DEMONSTRATE THAT SECTION 70c FIXES THE TRUSTEE'S HYPOTHETICAL CREDITOR STATUS AT THE DATE OF BANKRUPTCY AND DOES NOT PERMIT THE TRUSTEE TO SEARCH BACK FOR MONTHS OR YEARS PRIOR TO SUCH BANKRUPTCY DATE IN QUEST OF A MORE ADVANTAGEOUS POSITION OF ATTACK.

In this portion of the argument, Respondent will demonstrate that a detailed review of present Section 70c in the light of its history, its purpose, its language and context compels the conclusion reached by the Court of Appeals, namely that the rights of the trustee thereunder are fixed at and as of the date of bankruptcy.

It is significant that neither Petitioner's brief nor the authorities cited by Petitioner contain any detailed analysis of Section 70c or any use of the customary techniques of statutory interpretation. Both Petitioner and the cases cited by Petitioner, to the extent pertinent, appear to beg this basic question of what this language means and to assume a meaning which ignores history and the statutory setting of Section 70c and distorts the present language of that Section. What follows will demonstrate the error in their approach.

1. Interpretation and Genesis of Section 70c Prior to the 1952 Amendment.

This Court unanimously announced in 1915 the general principle that a trustee's status under the predecessor of present Section 70c accrues *for all purposes* at the date of bankruptcy, stating with reference to Section 47(a)(2) of the Bankruptcy Act as amended in 1910:

> "Although otherwise explicit, this provision does not designate the time as of which the trustee is to be regarded as having acquired the status indicated, and yet some point of time must be intended. Is it the date of the trustee's appointment, the filing of the petition in bankruptcy, or some time anterior to both? *When not otherwise specially provided, the rights, remedies, and powers of the trustee are determined with reference to the conditions existing when the petition is filed.* It is then that the bankruptcy proceeding is initiated, that the hands of the bankrupt and of his creditors are stayed, and that his estate passes actually or potentially into the control of the bankruptcy court. * * * Had it been intended that the trustee should take the status of a creditor holding a lien by legal or equitable process as of a time anterior to the initiation of the bankruptcy proceeding, it seems reasonable to believe that some expression of that intention would have been embodied in §47a as amended. As this was not done, *we think the better view, and one which accords with other provisions of the act, is that the trustee takes the status of such a credior as of the time when the petition in bankruptcy is filed.* Here the petition was filed almost two months after the contract was filed for record, and therefore the trustee was not entitled to assail it under the recording law of the state." (Emphasis supplied.)

Bailey v. Baker Ice Machine Company, 239 U. S. 268, 275-76, 36 S. Ct. 50, 54 (1915).

Essential to a true understanding of the question now before this Court is the fact that, between 1915 and 1952, nothing in the Congressional revisions of Section 47 and Section 70c and nothing in pertinent case law prior to 1954 provides even a colorable basis for Petitioner's position.

To document this fact in a manner convenient to the Court, Respondent has annexed hereto as Appendix 1 a comment on the genesis of present Section 70c from 1898 through its last amendment in 1952. Even a cursory reading of the statutory language through its various revisions prior to 1952 reveals Congressional affirmation of this Court's opinion in *Bailey.*

Petitioner has attempted to find some pedigree in case law prior to 1954 for the notion he urges upon the Court. There is none and it seems most convenient to document this by annexing as Appendix 2 a brief note as to the decisions cited by Petitioner, which establishes their irrelevancy.

In short, it was generally understood, prior to 1954, that the purpose of Section 70c was to create certain rights as of date of bankruptcy. Its meaning was deemed clear.

2. The 1952 Amendment—Congressional Intent.

In the 1950 general revision of the Bankruptcy Act, Section 70c was amended to read in pertinent part as follows:

> "* * * The trustee, as to all property of the bankrupt at the date of bankruptcy, whether or not coming into possession or control of the court, shall be vested as of the date of bankruptcy with all the rights, remedies, and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists."

By this amendment to Section 70c, the distinction between property in the possession of the bankrupt, and thus coming into the possession of the Bankruptcy Court at the date of bankruptcy, and property not so in possession was abolished. The trustee was given the status of a creditor holding a lien through legal or equitable proceedings as to both types of property, that is, whether in the possession of the Bankruptcy Court or not. The previous reference to the power of the trustee as a judgment creditor with an execution duly returned unsatisfied was deleted as no longer necessary.

In accomplishing the desired purposes, however, the language of the 1950 amendment involved the anomaly of conferring upon the trustee a lien even upon that property of the bankrupt to which the trustee already had title.

In order to remove the anomaly created by the language of the 1950 amendment, Congress enacted the 1952 amendment which changed Section 70c to read in pertinent part:

> "* * * The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt *could have obtained a lien* by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists." (Emphasis supplied.)

Petitioner's position rests solely upon the phrase "could have obtained a lien" inserted by the 1952 amendment, but his attempt to justify new doctrine upon the basis of this phrase is expressly negated by Congress.

The narrow Congressional intent as to the purpose of this 1952 amendment is clearly stated in House Report No. 2320 on S. 2234, 82nd Congress, 2nd Sess. (1952) as follows:

"*Section 23(c) of the bill makes a clarifying change in Section 70(c) of the Act.* Section 70(c) was amended in the last Congress (Public Law 461, 81st Cong., Act of March 18, 1950), simplifying the subdivision and conforming it to the amended section 60a. However, it is now recognized that the amendment did not accurately express what was intended. Since the trustee already has title to all of the bankrupt's property, it is not proper to say that he has the rights of a lien creditor upon his own property. What should be said is that he has the rights of a lien creditor upon property in which the bankrupt has an interest or as to which the bankrupt may be the ostensible owner. *Accordingly, the language of section 70(c) has been revised so as to clarify its meaning and state more accurately what is intended.*" (Emphasis supplied.)

As indicated by the italicized language in this House Report, the 1952 amendment was merely a *clarification* of some unfortunate language and did not signal a new and major departure in policy.

That this was and is the Congressional intent as to the scope of Section 70c is further confirmed by Congressional reaction to the contrary reading by the Second Circuit Court of Appeals.

After the decision in *Constance v. Harvey*, 215 F. 2d 57 (2d Cir. 1954) cert. den. 348 U. S. 913, 75 S. Ct. 294, action was initiated to correct the *Constance* error, and clarifying language was introduced as part of H. R. 7242. In favorably reporting this language, the House Committee on Judiciary stated in House Report 745, 86th Congress, First Session (August 3, 1959):

"From 1910 to 1954 it was assumed that the rights of the trustee under 70c accrue as of the date of bankruptcy and no earlier. However, in *Con-*

stance v. Harvey, 215 F. 2d 575 (2d Cir., 1954), cert. denied 346 U. S. 913 (1955), it was held that under Section 70c a trustee has the rights of an ideal hypothetical creditor who has acquired his claim prior to bankruptcy. * * *

* * * The holding in *Constance v. Harvey* by injecting into Section 70c the substance of 70e, created the statutorily unwarranted status of a hypothetical creditor with rights relating back to a date prior to bankruptcy. While bankruptcy is in effect a general levy on the property of the bankrupt for the benefit of his creditors, it is not a license for the trustee, irrespective of prejudice to creditors, to avoid at will any security given by the bankrupt which remained imperfected for any period of time prior to bankruptcy. Yet this is the effect of *Constance v. Harvey*. Under this decision the only limit to the power of the trustee is his ability to conceive of some right of a creditor that can be used as a basis for striking down imperfect transfers. The doctrine of *Constance v. Harvey* presents a very real threat to security transactions, the validity of which have hitherto not been subject to challenge under the Act. * * *"

H. R. 7242 passed both the House and Senate in the recent session of Congress and was sent to the President for signature, but the President vetoed the bill on September 21, 1960 because of certain other provisions therein which dealt with Federal tax lien priorities*

***The President's veto message stated:**

"I have withheld my approval of H. R. 7242, 'To amend sections 1, 57j, 64a(5), 67b, 67c, and 70c of the Bankruptcy Act, and for other purposes.'

"I recognize the need for legislation to solve certain problems regarding the priority of liens in bankruptcy, but this bill is not a satisfactory solution. It would unduly and unnecessarily prejudice

(Continued on next page)

3. Petitioner's Position is Negated by the Statutory Context of Section 70c.

Petitioner's effort to distill a new substantive rule from the 1952 amendment not only ignores express Congressional intent as to the scope of Section 70c, but also ignores other provisions in the Bankruptcy Act.

For example, consider the relationship of Petitioner's version of Section 70c to Section 70e. As noted in House Report 745, *supra,* Petitioner urges that the substance of Section 70e be injected into Section 70c. Petitioner argues (Br. 12) that occasions may arise where resort to Section 70e might still be necessary and, therefore, Section 70e is not rendered completely superfluous by his position. This argument misses the point that Congressional creation of certain rights under Section 70e which *must be derived from an actual existing creditor* with a provable claim at date of bankruptcy strongly negates an intention to authorize the trustee under 70c to unsettle security arrangements perfected prior to bankruptcy where no actual creditor was prejudiced by any delayed compliance with state filing or recording laws.

(Continued from preceding page)

the sound administration of Federal tax laws. In some cases, for example, mortgages would be given an unwarranted priority over Federal tax liens even though the mortgage is recorded after the filing of the tax lien.

"This and other defects of the bill can, I believe, be corrected without compromising its primary and commendable purpose. The Treasury Department and the proponents of H. R. 7242 have been working toward solution of recognized problems in present law. Further cooperative efforts should produce satisfactory legislation that would avoid the undesirable effects of this bill."

C. C. H. Bankruptcy Law Reporter, Report Letter #138 dated September 21, 1960.

Moreover, it must be emphasized that Congressional policy in striking a proper balance between secured and unsecured creditors has been formulated with due recognition that there must be some repose in arrangements made between the bankrupt and his creditors prior to bankruptcy. Thus Section 60 of the Bankruptcy Act (11 U. S. C., Section 96) does not permit a trustee to set aside preferential transfers unless they were made within four months of the date of bankruptcy. Similarly, Section 67a(1) (11 U. S. C., Section 107a(1)) has a four-month limitation on the voidability of attachment and other liens obtained by creditor process and even Section 67d (11 U. S. C., 107d) has a one-year limitation upon attacks against fraudulent transfers.

Petitioner, however, would have this Court ignore this Congressional policy of repose after a reasonable time elapses prior to bankruptcy and declare that Congress by the 1952 amendment of Section 70c made a major departure from such policy (though preserving the fixed time limitations in the other sections above noted) which permits a trustee to attack all manner of security transactions entered into for contemporaneous consideration and in good faith years prior to bankruptcy so long as the trustee's imagination can evoke a hypothetical situation in which a hypothetical creditor might have had such right.

Petitioner is saying in effect that a creditor is secure in taking preferences more than four months before bankruptcy, can perfect a lien by attachment or other process more than four months before bankruptcy and can even engage in transactions in fraud of other creditors so long as he does so more than one year before bankruptcy. If, however, a creditor enters into a bona fide security arrangement for contemporaneous consideration and delays one day more than the time allowed by state law to perfect

this security by filing or recording, such delay is fatal, even though it occurs many years before date of bankruptcy and even though no creditor is prejudiced thereby.

It is noteworthy that Petitioner has nowhere attempted to urge that his position is either equitable or sensible.

4. Analysis of the 1952 amendment demonstrates that Petitioner's position involves poor grammar as well as bad law.

Petitioner strains credulity in asserting that Congress in 1952 intended to make such a major extension of the trustee's rights, contrary to policies imbedded in Sections 70e, 60 and 67 of the Bankruptcy Act, although (i) there is no comment upon such extension in any of the legislative history, (ii) the existing comment by Congress negates any intention to make such change and (iii) no comment upon such change can be found in any of the authorities in the field until provoked by a decision of the Second Circuit Court of Appeals two years after the 1952 amendment. In short, Petitioner has no real basis to justify his position in terms of legislative history or Congressional intent, and must, it would seem, rely upon exegesis of the text itself.

Neither Petitioner's brief nor the cases he relies upon reveal any analysis of the language of present 70c and it is perhaps this very lack of analysis which created the conflict before this Court.

Petitioner reads Section 70c to mean: "If a hypothetical creditor can be imagined in a situation existing any time prior to bankruptcy, and such fiction produces a creditor who could have obtained a lien on Bankrupt's property at date of bankruptcy, then trustee is vested with a lien thereon."

This reading ignores important and careful language of qualification in Section 70c.

First, the phrase "*upon which* a creditor could have obtained a lien by legal or equitable proceedings at date of bankruptcy" clearly refers back to and defines the noun "property".

Next, having defined the property involved (and, as noted above, this was the only purpose of the 1952 amendment), the language vests the trustee *as of date of bankruptcy* with "all the rights, remedies and powers of a creditor *then* holding a lien thereon by such proceedings, whether or not *such* a creditor (i. e., a creditor holding a lien thereon at date of bankruptcy) actually exists."

Petitioner's semantic error, in short, lies in ignoring the careful qualifications and clear back references in the statutory text itself. It is obvious that the *statutory* hypothetical creditor comes into fictional existence and his status is fixed for all purposes at date of bankruptcy, and not before.

Respondent's textual analysis, it is submitted, is not only grammatically sound, but completely in accord with this Court's expression in *Bailey*, quoted above.

Finally, it should be emphasized that even if Petitioner could find an ambiguity in this language, it would defy probability and good sense to conclude that Congress intended to make a major change in bankruptcy law by resort to ambiguity or nuance.

C. THE POSITION OF THE COURT OF APPEALS IN THIS CASE IS SOUND AUTHORITY AND FINDS SUPPORT ELSEWHERE. THE ONLY AUTHORITY TO THE CONTRARY IN THE SECOND CIRCUIT IS NOT INFUENTIAL.

Appendix 2 documents the fact that Petitioner's authorities outside the Second Circuit are irrelevant. Indeed, even Petitioner admits the irrelevancy of many of these cases to the question before this Court and merely cites them in an effort to find analogies to support his position. This effort encounters the familiar difficulties of trying to draw conclusions about bananas from an examination of apples.

One thing is clear from Petitioner's brief. The only pertinent authorities supporting his position are two cases in the Second Circuit, *Constance v. Harvey, supra,* and *Conti v. Volper,* 229 F. 2d 317 (2d Cir., 1956). The following discussion of these decisions will indicate their error.

The facts of *Constance v. Harvey, supra,* were as follows: On November 23, 1949 Constance sold to Reilly, the bankrupt, residing in the town of Watervliet, Albany County, New York, a roadside diner located in the City of Albany, New York. The purchase price was $35,000, payable $15,000 in cash and $20,000 by a purchase money mortgage executed by Reilly in favor of Constance. On November 25, 1949, the attorney for Constance sent copies of the mortgage to the County Clerk of Albany County and the Town Clerk of Watervliet for filing, together with the appropriate filing fees. The copy of the mortgage sent to the Albany County Clerk was duly filed but the copy sent to the Watervliet Clerk was returned with a notation, "Filed in Albany."

It was admitted that Watervliet was the only proper place of filing and the filing in the Albany County Clerk's office was of no avail. It was not until October 5, 1950, nearly eleven months after its execution, that the mortgage was properly filed with the Watervliet Town Clerk. Reilly was adjudicated a bankrupt on October 23, 1951. The sole asset of the estate was the diner which was sold by the trustee for $22,150 against which proceeds Constance claimed a valid lien of $15,650, the unpaid balance of the purchase price of the diner.

The Court held that the mortgage was not seasonably filed under the New York law, and then approached the question of what effect, if any, the belated filing would have under Section 70c of the Bankruptcy Act. The court in its original opinion held that if the chattel mortgage was filed prior to the date of bankruptcy, Section 70c of the Bankruptcy Act would not help the trustee, stating:

> "Hence under Sec. 70, sub. c the Trustee did not have the status of a lien creditor with respect to this property unless the petition in bankruptcy was filed *prior* to October 5, 1950, when the chattel mortgage was filed by the Watervliet Town Clerk. *4 Collier on Bankruptcy*, pp. 1272, 1273, 1287-1293."

The Court then, before remanding the case to the district court, *sua sponte*, reversed its position, stating at page 575:

> "Since an existing creditor without notice of the chattel mortgage, could have obtained a lien at the time of the filing of the petition in bankruptcy, and since under Sec. 70, sub. c of the Bankruptcy Act the Trustee was entitled to be put in the position of an 'ideal' hypothetical creditor—*Hoffman v. Cream-O-Products*, 2 Cir., 180 F. 2d 649, certiorari denied 1950, 340 U. S. 815, 71 S. Ct. 44, 95 L. Ed. 599—we think his position must prevail over that of the mortgagee-appellant."

As indicated, the only case the Court relied upon in rendering its final decision was *Hoffman v. Cream-O-Products.* In that case the conditional bill of sale was filed for record in the proper Register's Office but the contemporaneously executed written agreement by which the parties specified the purchase price of the machines and the time and manner of payment thereof, was *never* filed for record. The failure to file this supporting document invalidated the reservation of title. Thus, the *Hoffman* case was simply one of many cases that have held that, if the security instrument is not properly filed, as required by local law, prior to the date of bankruptcy, the trustee prevails because his lien under the provisions of Section 70c is superior to that of a creditor whose lien is invalid, and who thus has no lien at all. The *Hoffman* case does not support the decision rendered in *Constance.*

The second case, *Conti v. Volper,* which follows the *Constance* decision, is an abbreviated one. The full text of the decision is as follows:

> "*Constance v. Harvey,* 2 Cir. 1954, 215 F. 2d 571, reluctantly followed by Judge Byers, may seem to reach an inequitable result, but Sec. 70, sub. c, of the Bankruptcy Act, 11 U. S. C. A., §110, sub. c, provides: 'The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists'; and it is difficult to see how such plain language could be disregarded."

The district judge in this same case (*sub nomine In re Gondola Associates,* 132 F. Supp. 205) found it difficult to

reconcile his decision with the equitable purposes of the Bankruptcy Act, but felt bound by *Constance v. Harvey*. He stated at page 205:

> "* * * The result here reached seems incongruous: a state statute enacted to protect creditors who are such at a given date is held to operate in favor of a trustee in bankruptcy who really stands in empty shoes, for he occupies a space which does not exist, since there is no creditor who might enforce the right which he asserts."

It is significant that neither *Constance v. Harvey* nor *Conti v. Volper*, made any reference to the purpose of the Bankruptcy Act or Section 70e; that the Second Circuit did not consider the relationship of Section 70c and 70e or other sections of the Act; that they did not even mention the Congressional intent and history of Section 70c, nor attempt any analysis of the language they purported to interpret. Rather, the Second Circuit has merely wrenched the words "could have obtained a lien" out of context of Section 70c and given them an effect contrary to their clear meaning and the Congressional intent.

Further, the *Constance* decision was an abrupt departure from previous interpretations of Section 70c without any reliance on precedent and without consideration in the opinion of the policy matters involved. Prior to *Constance* all of the cases held that if the lien instrument was filed prior to the date of bankruptcy, even though untimely filed, Section 70c by itself was of no value to the trustee. Where filing preceded bankruptcy, the trustee must prevail if at all under Section 60 of the Act if within 4 months prior to bankruptcy, or under Section 70e of the Act and prove the existence of an actual interim creditor on whose behalf the trustee could then proceed for the benefit of the estate.

The Court in *Constance v. Harvey, supra,* without giving any consideration to previous decisions, in effect held that all the previous cases were in error and that the trustee's lien at the date of bankruptcy would be superior to a creditor whose security instrument is filed prior to the date of bankruptcy, even if there was no creditor who could complain.

The *Constance v. Harvey* decision has been severely criticized by scholars and authorities in the field. Benjamin Weintraub, Harris Levin and Howard N. Beldock in *The Strong Arm Clause Strikes the Belated Chattel Mortgage,* 25 Ford. L. Rev. 261 (reprinted in *Journal of National Association of Referees in Bankruptcy,* Vol. 31, No. 2, page 35 at 39, April, 1957), say:

> "The United States Court of Appeals for the Second Circuit has now twice stated its interpretation of section 70(c) of the Bankruptcy Act. Secured lenders and anyone claiming through them must beware of the rights, remedies and far reaching powers of the strong-armed trustee in bankruptcy. In brief, it is submitted that the status gived a trustee by the Court's interpretation of section 70(c), as an ideal hypothetical creditor who can reach back to a date anterior to the filing of a bankruptcy petition, *is unsound and constitutes an erroneous interpretation of the section.* It is significant that the decision in *Constance v. Harvey* has been recently disapproved by a resolution of the National Bankruptcy Conference.[52] (Emphasis supplied.)

---

[52] See Summary of Proceedings, National Bankruptcy Conference, 1956 Annual Meeting, Resolution No. 36: 'Resolved, that it is the sense of the National Bankruptcy Conference that the trustee in bankruptcy gets his standing under Section 70(c) as of the date of the filing of the petition, with no privilege of relation back and without prejudice to such rights as the trustee might have under Section 70(e) or any other provision of the Bankruptcy Act.'"

Likewise, Charles Seligson, Professor of Law at New York University School of Law, and one of the authors of *Collier on Bankruptcy*, in Creditors' Rights, (reprinted in *Journal of National Association of Referees in Bankruptcy*, Vol. 31, No. 4 page 113 at 118, October, 1957) said:

> "That the doctrine of the *Constance* case *compels an inequitable result is hardly open to question.* In the absence of bankruptcy, no creditor could have challenged the mortgage in the *Conti* case save one who was such at the time the chattel morgage was filed. A creditor with a claim coming into existence after the filing of the chattel mortgage could not do so, however long the delay in filing. (*In re Myers*, 19 F. 2d 600 (N. D. N. Y. 1926).). Nevertheless, the trustee in bankruptcy, who was not appointed until long after the filing of the mortgage and whose title and rights generally arose as of the date of the filing of the bankruptcy petition, was permitted to take action that no creditor at bankruptcy could take. The trustee represents all creditors. Thus, the avoidance of the chattel mortgage inured to the benefit of the general creditors, not one of whom was injured by the belated filing. These general creditors were unjustly enriched at the expense of the mortgagee, whose rights under local law were disregarded. It is inconceivable that Congress could have intended such an inequitable result in fashioning the strong-arm provisions of Section 70(c).
>
> This doctrine does not seem to have been followed in any other jurisdiction." (Emphasis supplied.)

Similarly in Marsh, *Constance v. Harvey*—"The Strong-Arm Clause" Re-evaluated, 43 Calif. L. Rev. 65, 73-74 (1955) it is stated:

> "Section 70(e) permits the trustee to exercise the right under state or federal law of any actual creditor having a provable claim to avoid any transfer made or suffered by the bankrupt * * *. Under

the rule of the *Constance* case the trustee under the strong-arm clause can represent a hypothetical creditor who extended credit at whatever time is most advantageous to him. It is apparent that the rights of such a hypothetical creditor would always be equal to or greater than those of any actual creditor and, therefore, if this interpretation is adopted Section 70(e) has become superfluous for the purpose of avoiding transfers by the bankrupt. The trustee should always proceed under Section 70(c).

"* * * (A)s long as Section 70(e) remains in the Act, it is at least arguable that it evidences an intent on the part of Congress that in some conceivable circumstances the rights of the trustee to avoid a transfer by the bankrupt should be measured by the rights of the actual creditors having provable claims * * *."

The foregoing citations and excerpts do not exhaust the considerable body of critical literature provoked by *Constance*. Additional materials are collected and reviewed in a comment in *57 Michigan Law Review,* 1227 (June 1959).

In sharp contrast to the cursory expressions on this question by the Second Circuit Court, the Court of Appeals for the Sixth Circuit supported its decision in this case by a careful opinion rejecting an over-simple literal approach to this important question and setting forth in detail its reasons for such rejection. The District Court below did likewise.

Similarly, in the Western District of Missouri, the Court in *In re Billings,* 170 F. Supp. 253 (1959) carefully examined and rejected the *Constance* position. The Fifth Circuit has indicated its reluctance to accept the mischievous consequences of *Constance, Blackford v. Commercial*

Credit Corporation, 263 F. 2d 97 (5th Cir. 1959), Note 14 at pp. 111 and 112. Very recently the Tenth Circuit Court of Appeals was presented with a set of facts where the *Constance* notion would be applicable and adopted a position parallel to that of the Sixth Circuit, holding that Section 70c gave the trustee a status for all purposes as of date of bankruptcy and was inoperative against a chattel mortgage perfected prior thereto. *Bergin v. Waterson*, 279 F. 2d 193 (10th Cir. 1960).

We believe that the foregoing case discussion and the consideration of cases in Appendix 2 clearly establishes that (i) the *Constance* decision has been rejected outside the Second Circuit and, (ii) even the District Courts in the Second Circuit have found it troublesome.

D. STRONG PRACTICAL AND POLICY CONSIDERATIONS CONFIRM THE SOUNDNESS OF THE CONSTRUCTION ADOPTED BY THE COURT OF APPEALS.

1. The Mischievous Effects of Constance on Chattel Mortgage Financing.

The chattel mortgage is and has long been one of the major security devices in commerce and finance. Not only do most installment purchases of automobiles involve a chattel mortgage, as in this case, but also commercial loans to businesses large and small are very often secured in whole or in part by chattel mortgages.

It is evident that Petitioner's position in this case places in jeopardy substantially all of the many millions of dollars of loans secured by chattel mortgages (other than purchase money mortgages) during the effective period of Public Act 233 of 1957 (September 27, 1957, to March 19, 1960), for the validity of the security interest is subject to a mortgagor's decision to file in bankruptcy or the

decision of general creditors to initiate involuntary proceedings.

In sharp contrast to this Michigan situation is that existing in the State of New York when *Constance v. Harvey* was decided. New York security law gave the mortgage lender a reasonable time to file the mortgage and reasonable diligence resulted in a security interest good against all creditors. Thus, the Second Circuit Court of Appeals may very likely have supposed that the rule enunciated in *Constance v. Harvey* penalized only the dilatory and it seems reasonable to surmise that if that Court's attention had been directed to a situation such as that in Michigan, it would have been reluctant indeed to destroy a major security device long established and daily relied upon in good faith in the financing of consumer needs and the needs of business and commerce.

Petitioner is fully aware of the drastic results of his position and yet he has advanced no argument that these results are reasonable or equitable or in harmony with the policy of the Bankruptcy Act or of the Michigan Chattel Mortgage Law.

Clearly, his position cannot be justified in terms of the policy against secret liens expressed in the Michigan Act, for the Michigan policy is clearly limited to protecting interim creditors acting without full knowledge of the borrower's financial position and has nothing to do with the mythical creditor upon whom Petitioner must rely.

Nor are the drastic effects of the *Constance* doctrine limited to states such as Michigan or California—see, e. g., *Wolpert v. Gripton*, 213 Cal. 474, 2 P. 2d 767 (1931)—which had or have an immediate recording requirement.

As *Constance* itself held, even in the many states where a statutory grace period or "reasonable time" concept obtains, a belated filing leaves the chattel mortgage apparently forever subject to attack. Respondent respectfully submits that nowhere is the inequity of such a rule better demonstrated than in the facts of *Constance* itself.

2. The Limitations Problem.

As previously noted in Section B.3. of this brief, Congress has expressly placed certain time limitations upon the trustee's power to attack various transactions occurring more than a stated period prior to date of bankruptcy.

Assuming Petitioner's notion that Section 70c is *sui generis* and has no relationship with this policy of repose expressed in the Bankruptcy Act, how far in the past can the ambulatory hypothetical creditor rummage? Once the Congressional birthdate (the date of bankruptcy) is abandoned as the point in time to which reference must be made in ascertaining the trustee's rights under Section 70c, where will the courts find guidance on this question? Indeed, can there be any logical time limitation on the trustee in such a case?

Perhaps Petitioner would limit his fantasy with a companion fantasy that the hypothetical creditor would be barred by the state statute of limitations hypothetically running against the hypothetical creditor whose rights the trustee is claiming at date of bankruptcy. Such a fantasy limitation would project various time limitations based on the statute of limitations applicable to the hypothetical contract creditor, would be inconsistent with the policy of the bankruptcy law, which brings uniformity of limitations to other transactions regardless of the state of oc-

currence, and would purport to preclude the trustee by the running of time before his hypothetical rights had even accrued. Moreover, if the trustee is such an "ideal" creditor under Section 70c, so that by Petitioner's argument he has the rights of a hypothetical creditor long prior to the date of bankruptcy, then even more clearly will a hypothesized state statute of limitations be ineffective as a time bar. For just as the trustee's hypothetical creditor may be one assumed to be without notice when actually notice has been given to others or one who has recorded when there was no actual recording,* so too would that hypothetical creditor be one who came within the state statutory provisions *suspending* the limitation. Thus any companion fantasy of a state-generated time limitation would not be effective to limit the trustee's ability to roam indefinitely into the past.

3. Effects of *Constance* upon other Commercial Transactions.

Discussion to this point has centered on the effects of Petitioner's position under one portion of security law, the chattel mortgage filing statutes. The mischief is not limited to this area alone.

For example, Michigan has a Bulk Sales Act (as do other states) which requires notice to all creditors of the seller under certain conditions, Michigan Compiled Laws 1948, Section 442.1; Michigan Statutes Annotated, Section 19.361. Assuming a bulk sale long before the seller filed a petition in bankruptcy, and assuming all actual creditors had been notified, the trustee under the *Constance* theory could assert the rights of a hypothetical creditor without

---

*See *Commercial Credit Co., Inc. v. Davidson*, (5th Cir., 1940), 112 F. 2d 54, and *Sampsell v. Straub*, (9th Cir., 1951), 194 F. 2d 228; cert. den. 343 U. S. 927, 72 S. Ct. 761.

notice existing at the time of sale and thus destroy a good faith arrangement completed years before.

Again, Michigan has a Bulk Mortgage Act (Michigan Compiled Laws, 1948, Section 442.51; Michigan Statutes Annotated, Section 19.371) with notice requirements which could not be discharged as to the hypothetical creditor. This would present a similar problem.

Examples might be added, from Michigan and from other states, but the foregoing seems sufficient to indicate that Petitioner's position drastically affects myriad relationships and transactions in commerce and finance.

Clearly, Petitioner cannot avoid the force of these practical considerations by the argument that these are problems for the legislature or Congress and not for the courts. This position collapses upon examination, for it seems evident that it was *Constance v. Harvey* that changed the law and this Court is merely being asked to recognize and to avoid the error of the Second Circuit Court of Appeals and the consequent mischief created by its decision.

It is one thing when a Court, after full consideration, applies a clear Congressional or other legislative mandate; it is quite another when a Court, with no consideration of Congressional intent or legislative history, fastens a new meaning upon a statute contrary to the meaning theretofore generally accepted.

It is submitted that this Court in its function of unifying and purifying Federal law may properly put an end to the erroneous construction of Section 70c urged by Petitioner.

CONCLUSION

For all of the foregoing reasons, Respondent respectfully submits that this Court should affirm the Sixth Circuit Court of Appeals in its holding that Section 70c does not empower the trustee to stand in the empty shoes of a fictional intervening creditor and to set aside a chattel mortgage otherwise perfected under state law.

Respectfully submitted,

HENRY I. ARMSTRONG, JR.,
Attorney for Respondent,
1400 Buhl Building,
Detroit 26, Michigan.

BODMAN, LONGLEY, BOGLE,
ARMSTRONG & DAHLING,
RICHARD D. ROHR,
CARSON C. GRUNEWALD,
Detroit, Michigan,
Of Counsel.

October —, 1960.

APPENDIX 1

HISTORICAL DEVELOPMENT OF SECTION 70c

The early antecedent of present Section 70c, the so-called "strong arm clause," was Section 70a(5) of the Bankruptcy Act of 1898 which vested in the trustee the title of the bankrupt to property "* * * which might have been levied upon and sold under judicial process against him." The adjudication in bankruptcy did not operate as the equivalent of a judgment or attachment or other specific lien upon the property and where there was no actual creditor who had acquired a lien before bankruptcy, the trustee was not in a position to attack the validity of another lien or transaction.

Accordingly, Congress in the 1910 amendment to the Bankruptcy Act vested the trustee with all of the lien rights which any creditor could have acquired under state law as of the date of bankruptcy. The language of Section 47a(2) (considered by this Court in *Bailey v. Baker Ice Machine Company*, 239 U. S. 268, 36 S. Ct. 50, 1915) was as follows:

> "Trustees shall respectively: * * * (2) Collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estate as expeditiously as is compatible with the best interests of the parties in interest; and such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment

creditor holding an execution duly returned unsatisfied. * * *"

The Chandler Act of 1938 retained the substance of amended Section 47a(2) with some minor changes in phraseology, but shifted the section to become Section 70c. The 1938 version of Section 70c, leaving out the first sentence which is not pertinent, read:

> "* * * The trustee, as to all property in the possession or under the control of the bankrupt at the date of bankruptcy or otherwise coming into the possession of the bankruptcy court, shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists; and, as to all other property, the trustee shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists."

That is the way this section stood until the 1950 amendment. The 1950 version of Section 70c, again leaving out the first sentence which is not applicable, read:

> "* * * The trustee, as to all property of the bankrupt at the date of bankruptcy, whether or not coming into possession or control of the court, shall be vested as of the date of bankruptcy with all the rights, remedies, and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists."

In the 1950 amendment to Section 70c, the distinction between property in the possession of the bankrupt, and thus coming into the possession of the Bankruptcy Court at the date of bankruptcy, and property not so in posses-

sion was abolished. The trustee was given the status of a creditor holding a lien through legal or equitable proceedings as to both types of property, that is, whether in the possession of the Bankruptcy Court or not. The reference to the power of the trustee as a judgment creditor with an execution duly returned unsatisfied was thus deleted as no longer necessary.

The 1952 amendment to Section 70c of the Bankruptcy Act made no substantial change. It merely clarified the section so as to eliminate the incongruity of the trustee having a lien on the bankrupt's property. As stated in the House Report on the 1952 amendment:

> "* * * However it is now recognized that the 1950 amendment did not accurately express what was intended. Since the trustee already has title to all of the bankrupt's property, it is not proper to say that he has the rights of a lien creditor upon property in which the bankrupt has an interest or as to which the bankrupt may be the ostensible owner. Accordingly, the language of Section 70(c) has been revised so as to clarify its meaning and state more accurately what is intended." House Report No. 2320 on S. 2234, 82d Cong., 2d Sess., (1952) 16.

Section 70c of the Bankruptcy Act as it now stands, reads as follows:

> "* * * The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

APPENDIX 2

PERIPHERAL OR IRRELEVANT CASES CITED BY PETITIONER

Petitioner's brief is replete with a discussion of numerous case authorities which, in Respondent's submission, either deal with points which are not really at issue here or merely reflect and underscore the general understanding as to the function of Section 70c.

These cases are dealt with in this Appendix in order that the real question before this Court is not obscured by extraneous materials.

1. Cases dealing with the source of trustee's rights.

Petitioner cites *In re Kranz Candy Co.*, (7th Cir. 1954) 214 F. 2d 588; *In re Consorto Construction Co., Inc.*, (3rd Cir. 1954) 212 F. 2d 676; and *Miller v. Sulmeyer,* (9th Cir. 1959) 263 F. 2d 513; cert. den. 361 U. S. 838, 80 S. Ct. 55 (1959), to the general effect that the trustee's powers are not necessarily derived from the rights of existing creditors. Respondent has no quarrel with this statement as an abstract proposition of law, but as applied to the facts of the immediate case, this generality is of little utility. *Consorto* involved a chattel mortgage belatedly recorded (but recorded more than four months prior to bankruptcy) which was held valid against an attack by the trustee based on Section 70c. The chattel mortgage was void *ab initio* in *Kranz,* while *Miller v. Sulmeyer* involved a claim by the trustee based on rights of actual interim creditors having priority under state law and the court apparently sustained such claim upon the basis of Section 70e.

2. Cases dealing with the "Ideal Creditor" concept.

In re Urban, (7th Cir. 1943) 136 F. 2d 296, involved merely the normal application of Section 70c. Here, at state law, a creditor extending credit and obtaining a lien at date of bankruptcy would have obtained priority over the chattel mortgage since the mortgage was never properly filed.

In re Calhoun Supply Co., (D. C. Ala. 1911) 189 F. 537, is relied upon by Petitioner as authority that the trustee is invested with the rights of every type of creditor, real or hypothetical. The case, however, is nowhere near that broad. It was there argued that "unless the term 'creditor holding a lien by legal or equitable proceedings' must necessarily include the term 'judgment creditor' so that every creditor holding a lien by legal or equitable proceedings is bound to be a judgment creditor, then the 1910 amendment does not endue the trustee with the rights of a judgment creditor." It was to this argument that the Court was directing itself when, immediately preceding the language quoted by Petitioner (Br. p. 16), it said:

> "It is true that the words quoted from the amendment must necessarily include within their proper meaning a judgment creditor, but that is a very different thing from saying that they must be construed so as to include no other class of lienholders than judgment creditors. It is sufficient, if one of the class of creditors, coming within the fair meaning of the words, is that of judgment creditors, even though other classes of lienholders, not judgment creditors, may also come within the fair meaning of the words." 539

3. Cases represented by Petitioner to anticipate the *Constance* decision.

Sampsell v. Straub, (9th Cir. 1951) 194 F. 2d 228; *cert. den.* 343 U. S. 927, 72 S. Ct. 761, much relied upon by Petitioner as heralding the arrival of *Constance,* held simply that where the judgment lien given the trustee by Section 70c was required by state law to be recorded in order to gain priority over a homestead exemption, unrecorded at the time of filing the petition in bankruptcy, that the trustee would be deemed to have recorded. Thus stated, the holding is really quite similar to several cases supporting the doctrine that where state priority is given only to a creditor extending credit without notice of an unrecorded instrument which would have priority if recorded, the trustee under Section 70c has the status of a creditor without notice. (See, e. g. *Commercial Credit Co., Inc. v. Davidson,* (5th Cir. 1940) 112 F. 2d 54.) *Sampsell* merely substitutes recording for notice.

The discussion of *In re Urban* above has established that it merely represents an accepted application of Section 70c to avoid liens unprotected before date of bankruptcy.

Great stress is placed by Petitioner upon *McKay v. Trusco Finance Co. of Montgomery, Alabama,* (5th Cir. 1952) 198 F. 2d 431, yet *McKay* is quite compatible with the normal interpretation of Section 70c and not at all analogous to *Constance.* In *McKay,* the instrument (which the Court regarded as either a chattel mortgage or conditional sales contract) was *unrecorded* when the petition in bankruptcy was filed. Under state law, it was void as against judgment creditors if a conditional sales contract and as against creditors without notice if a chattel mortgage. There was no need to employ any fiction of extending credit at a time earlier than the filing of the petition in

bankruptcy and, there apparently being no actual creditor who could have upset the chattel mortgage or conditional sales contract, the court quite properly invoked Section 70c. That the court treated the trustee as a creditor without notice is not at all surprising nor is its holding that the status of the trustee as a creditor with a lien necessarily embraces a simple creditor.

Further, Petitioner's view that *McKay* anticipated *Constance* is definitely not shared by the 5th Circuit Court of Appeals which decided *McKay*, for in the more recent decision, *Blackford v. Commercial Credit Corporation* (5th Cir. 1959) 263 F. 2d 97, at Note 14 on pp. 111 and 112, the Court stated as follows:

> "[14] Collier states that Section 70c may be of little help, 4 *Collier, Bankruptcy*, Sec. 70.55 at 1286 (14th ed. 1956). *We would not wish to predict our ruling now, but* the widespread criticism of *Constance v. Harvey*, 2 Cir., 1954, 215 F. 2d 571, and *Conti v. Volper*, 2 Cir., 1956, 229 F. 2d 317, see 4 *Collier, supra*, Supplement, additions to pp. 1258, citing *Marsh, Constance v. Harvey—The 'Strong-Arm Clause' Re-Evaluated*, 43 Calif. L. Rev. 65 (1955); 1270, n. 2; 1272; 1274, at least suggest that if Alabama law finally declares that collection cuts off all creditors except, say, (1) existing or (2) subsequent to assignment but prior to collection, we should *be certain that reasonable reconstruction of Section 70(c) justifies a result which might otherwise be extremely artificial.*" (Emphasis supplied.)

SUPREME COURT OF THE UNITED STATES

No. 94.—October Term, 1960.

Wm. G. Lewis, Trustee, Petitioner, v. Manufacturers National Bank of Detroit.	On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit.

[January 9, 1961.]

Mr. Justice Douglas delivered the opinion of the Court.

The bankrupt borrowed money from respondent on November 4, 1957, giving as security a chattel mortgage on an automobile. In Michigan, where the transaction took place, mortgages were void as against creditors of the mortgagor unless filed with the Register of Deeds [1] with a special dispensation to purchase money mortgages if filed within 14 days of the execution of the mortgage. This mortgage, however, was not a purchase money mortgage; and though executed on November 4, 1957, it was not recorded until November 8, 1957.

Over five months later—on April 18, 1958—the borrower filed a voluntary petition in bankruptcy and an adjudication of bankruptcy followed, petitioner being named trustee.

There was no evidence that any creditor had extended credit between November 4, the date of the execution of the mortgage, and November 8, the date of its recordation. But since the mortgage had not been recorded immediately, the referee held that it was void as against

---

[1] Mich. Comp. L. 1948, § 566.140, as amended by Pub. Acts 1957, No. 233. In 1959, by Pub. Acts 1959, No. 110, a 10-day grace period was given to all mortgagees *vis-a-vis* creditors.

the trustee. The referee relied upon § 70 (c) of the Bankruptcy Act, 11 U. S. C. § 110 (c) which, so far as material here, reads:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

He ruled that § 70 (c) "clothes the Trustee with the rights of a creditor who could have obtained a lien at the date of bankruptcy whether or not such a creditor exists." He concluded that under Michigan law a creditor could have taken prior to the mortgage had he extended credit during the four-day period when the mortgage was "off record" and that therefore the trustee can claim the same rights, even though there was no such creditor. The District Court overruled the referee and the Court of Appeals affirmed the District Court. 275 F. 2d 454. The case is here on a petition for a writ of certiorari which we ganted because of a conflict between that decision and *Constance* v. *Harvey*, 215 F. 2d 571, decided by the Court of Appeals for the Second Circuit and subsequently followed by the same court in *Conti* v. *Volper*, 229 F. 2d 317. 363 U. S. 837.

Petitioner's case turns on the words, "upon which a creditor of the bankrupt could have obtained a lien . . . whether or not such a creditor actually exists," contained in § 70 (c).

Prior to 1910 the trustee had no better title to the property than the bankrupt had. See *York Mfg. Co.* v. *Cassell*, 201 U. S. 344, 352; *Zartman* v. *First National Bank*,

216 U. S. 134, 138. The provision with which we are here concerned was written into the law in 1910 to give the trustee all the rights of an ideal judicial lien creditor.[2] The predecessor of the present § 70 (c) was § 47 (a)(2) of the 1910 Act which provided in relevant part:

> ". . . such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment creditor holding an execution duly returned unsatisfied."

That language was held to give the trustee the status of a creditor "as of the time when the petition in bankruptcy was filed." *Bailey* v. *Baker Ice Machine Co.*, 239 U. S. 268, 276.

---

[2] See MacLachlan, Bankruptcy (1956), p. 187. The Committee Report concerning the 1910 Amendment said:

"It is evident that in the proposed amendment attempt is made to give effect to two ideas quite distinct: First, that as to the property in the custody of the bankruptcy court the bankruptcy trustee shall be considered to have the same title that a creditor holding an execution or other lien by legal or equitable proceedings levied upon that property would have under state law; and, second, that as to property not in the custody of the bankruptcy court the trustee should stand in the position of a judgment creditor holding an execution returned unsatisfied; thus entitling him to proceed precisely as an individual creditor might have done to subject assets. In this way, in effect, proceedings in bankruptcy will give to creditors all the rights that creditors under the state law might have had had there been no bankruptcy and from which they are debarred by the bankruptcy—certainly a very desirable and eminently fair position to be granted to the trustee." H. R. Rep. No. 511, 61st Cong., 2d Sess., p. 7.

In 1938 the relevant provisions of § 47 (a)(2) were transferred to § 70 (c) with no material change.[3]

In 1950 § 70 (c) was recast to read as follows:

> ". . . The trustee, as to all property of the bankrupt at the date of bankruptcy, whether or not coming into possession or control of the court, shall be vested as of the date of bankruptcy with all the rights, remedies, and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists."

Thus the distinction between property in the possession of the bankrupt as of the date of bankruptcy and other property was abolished; and the trustee was given the status of a creditor holding a lien through legal or equitable proceedings as to both types of property. This 1950 Amendment, however, created an anomaly. The House Report[4] accompanying a 1952 amendment that cast § 70 (c) in its present form states:

> ". . . it is now recognized that the amendment did not accurately express what was intended. Since the trustee already has title to all of the bankrupt's property, it is not proper to say that he has the rights of a lien creditor upon his own property. What should be said is that he has the rights of a lien creditor upon property in which the bankrupt has an interest or as to which the bankrupt may be the ostensible owner. Accordingly, the language of section § 70 (c) has been revised so as to clarify its meaning and state more accurately what is intended."

We think that one consistent theory underlies the several versions of § 70 (c) which we have set forth, *viz.*, that the rights of creditors—whether they are existing or hypo-

---

[3] See MacLachlan, Bankruptcy (1956), p. 187; H. R. Rep. No. 1409, 75th Cong., 1st Sess., pp. 4, 34–35.

[4] H. R. Rep. No. 2320, 82d Cong., 2d Sess., p. 16.

thetical—to which the trustee succeeds are to be ascertained as of "the date of bankruptcy,"[5] not at an anterior point of time. That is to say, the trustee acquires the status of a creditor as of the time when the petition of bankruptcy is filed. We read the statutory words "the rights . . . of a judgment creditor [existing or hypothetical] then holding a lien" to refer to that date.[6]

---

[5] While § 70 (c) speaks of "the date of bankruptcy," that term is defined as "the date when the petition was filed." Section 1 (13), 11 U. S. C. § 1 (13).

[6] After the decision in *Constance* v. *Harvey*, 215 F. 2d 571, 575, Congress passed a bill to change its holding. The President vetoed the bill stating:

"I have withheld my approval of H. R. 7242, to amend sections 1, 57j, 64a (5), 67b, 67c, and 70c of the Bankruptcy Act, and for other further purposes.

"I recognize the need for legislation to solve certain problems regarding the priority of liens in bankruptcy, but this bill is not a satisfactory solution. It would unduly and unnecessarily prejudice the sound administration of Federal tax laws. In some cases, for example, mortgages would be given an unwarranted priority over Federal tax liens even though the mortgage is recorded after the filing of the tax lien.

"This and other defects of the bill can, I believe, be corrected without compromising its primary and commendable purpose." Cong. Rec., 86th Cong., 2d Sess., No. 15, Pt. 2, App. A7013.

The Committee Report, urging that amendment, made clear the inequity that might often result if § 70 (c) is construed as *Constance* v. *Harvey*, *supra*, construed it:

"The holding in *Constance* v. *Harvey*, by injecting into section 70c the substance of 70e, created the statutorily unwarranted status of a hypothetical creditor with rights relating back to a date prior to bankruptcy. While bankruptcy is in effect a general levy on the property of the bankrupt for the benefit of his creditors, it is not a license for the trustee, irrespective of prejudice to creditors, to avoid at will any security given by the bankrupt which remained imperfected for any period of time prior to bankruptcy. Yet this is the effect of *Constance* v. *Harvey*. Under this decision the only limit to the power of the trustee is his ability to conceive of some right of a creditor that can be used as a basis for striking down imperfect

This construction seems to us to fit the scheme of the Act.[7] Section 70 (e) enables the trustee to set aside fraudulent transfers which creditors having provable claims could void. The construction of § 70 (c) which petitioner urges would give the trustee power to set aside transactions which no creditor could void and which injured no creditor. That construction would enrich unsecured creditors at the expense of secured creditors, creating a windfall merely by reason of the happenstance of bankruptcy.

It is true that in some instances the trustee has rights which existing creditors may not have. Section 11, 11 U. S. C. § 29, gives him two years to institute legal proceedings regardless of what limitations creditors might have been under. Section 60, 11 U. S. C. § 96, gives him the right to recover preferential transfers made by the bankrupt within four months whether or not creditors had that right by local law. A like power exists under § 67 (a), 11 U. S. C. ~~§ 107 (a),~~ as respects the invalidation of judicial liens obtained within four months of bankruptcy when the bankrupt was insolvent. Section 67 (d), 11 U. S. C. § 107 (d), carefully defines transactions which may be voided if made "within one year prior to the filing" of the petition.

Congress in striking a balance between secured and unsecured creditors has provided for specific periods of

---

transfers. The doctrine of *Constance* v. *Harvey* presents a very real threat to security transactions, the validity of which have hitherto not been subject to challenge under the act. Moreover, this is a threat which is not required by the policy of the act, since the creditors who have been prejudiced by the imperfections of a transfer are normally protected under section 70e." H. R. Rep. No. 745, 86th Cong., 1st Sess., pp. 8–9.

[7] See Seligson, Creditors' Rights, Journ. Nat'l. Assoc. Referees in Bankruptcy, Oct. 1957, 113, 118; Marsh, *Constance* v. *Harvey*—"The Strong-Arm Clause" Re-Evaluated, 43 Cal. L. Rev. 65; Note, 57 Mich. L. Rev. 1227.

repose beyond which transactions of the bankrupt prior to bankruptcy may no longer be upset—except and unless existing creditors can set them aside.[8] Yet if we construe § 70 (c) as petitioner does, there would be no period of repose. Security transactions entered into in good-faith years before the bankruptcy could be upset if the trustee were ingenious enough to conjure up a hypothetical situation in which a hypothetical creditor might have had such a right. The rule pressed upon us would deprive a mortgagee of his rights in states like Michigan, if the mortgage had been executed months or even years previously and there had been a delay of a day or two in recording without any creditor having been injured during the period when the mortgage was unrecorded.

That is too great a wrench for us to give the bankruptcy system, absent a plain indication from Congress which is lacking here.

Affirmed.

MR. JUSTICE HARLAN: As the judge who wrote for the Court of Appeals in *Constance* v. *Harvey*, 215 F. 2d 571, I think it appropriate to say that I have long since come to the view that the second opinion in *Constance*, 215 F. 2d 575, was ill-considered. I welcome this opportunity to join in setting the matter right.

[8] See, *e. g.*, § 70e, concerning which H. R. Rep. No. 1409, 75th Cong., 1st Sess., p. 32, stated, "... under section 70(e) the trustee may avoid any transfer which any creditor might have avoided under applicable State law, and there is no time limitation in such case."